IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
DARREL DEA DUGGER and	)	**Case No. 97-30410**
GLORIA L. DUGGER,	)	
	)	
	)	**MEMORANDUM OF**
	)	**DECISION AND ORDER**
Debtors.	)	
	)	

HONORABLE TERRY L. MYERS, U.S. BANKRUPTCY JUDGE

Danny J. Radakovich, Lewiston, Idaho, for Debtors.

Gary L. McClendon, Office of the U.S. Trustee, Boise, Idaho.

This matter comes before the Court on the application of the above Debtors in Possession ("Debtors") for approval of employment of Danny J. Radakovich as their counsel and Ted Hartshorn, an Olympia, Washington CPA, as their accountant. § 327(a), § 1107.[1] The application requests that the approval of employment of these professionals be entered *nunc pro tunc* as of October 30, 1997, the date of filing of the Debtors' voluntary chapter 13

[1] Unless otherwise indicated, all references to "code," "title," "chapter" and "section" are to the Bankruptcy Code, 11 U.S.C. §§ 101 - 1330, and all references to "rule" are to the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.") 1001 - 9036. References to "L.B.R." are to the Local Bankruptcy Rules for the District of Idaho.

petition. The Debtors converted their chapter 13 case to a reorganization under chapter 11 on April 27, 1998.[2]

At hearing on this application held February 1, 1999, the U.S. Trustee raised several issues:

1. *Nunc pro tunc* approval of employment requires a greater showing of cause than has been established in this case.

2. *Nunc pro tunc* approval, at best, can only extend back to the effective date of the commencement of chapter 11 relief, when the code's requirement of Court approval of professionals' employment is triggered, and not to the initial chapter 13 filing.

3. The services rendered by Mr. Radakovich during the chapter 13 gave rise to a claim against the estate which had to be disclosed under § 329(b) and Rule 2016(b), and this claim may in and of itself be a disqualifying interest.

At the hearing, the Court noted its concern over these issues and some additional ones, and took them all under advisement. Mr. Radakovich was provided fifteen days to submit briefing in regard to these matters, but he declined to do so. The matter is now ripe for decision.

The Court has reviewed the record in this case and applicable authorities, and here sets forth its findings and conclusions. Rules 7052(b), 9014.

BACKGROUND

The Debtors filed for chapter 13 relief on October 30, 1997. Mr. Radakovich was counsel for the Debtors at that time. After Judge Hagan granted two extensions of time for the filing of schedules and statements, Rule

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[2] The matters addressed in this opinion were all generated in connection with the Debtors' chapter 11 disclosure statement and plan. The filing of those pleadings was triggered by the U.S. Trustee's motion to convert or dismiss this reorganization in December 1998 due to lack of activity or progress. The Debtors' disclosure statement has now been approved, but neither balloting nor the confirmation hearing has occurred. No trustee has been sought or appointed.

1007, the Debtors completed their filing on January 6, 1998. The response to Question 9 on the Statement of Affairs indicated that Mr. Radakovich had been paid $797.50 within the year prior to filing for his bankruptcy advice and consultation. This amount was also disclosed on Mr. Radakovich's § 329 disclosure filed on January 6, 1998. Additionally, contained within the Debtors' original Schedule D (secured claims) is a listing of Mr. Radakovich as a holder of a $3,530.61 lien on the Debtors' tavern business securing payment for 1997 nonbankruptcy legal services.[3]

The case was converted to chapter 11 upon the Debtors' motion filed in March 1998. The effective date of conversion was April 27, 1998, which followed a hearing Judge Hagan held on March 31. No additional disclosures were made by counsel at conversion, nor was approval of employment sought at that time. That application only came nine months later after the U.S. Trustee's raised concerns over the progress of the case. As noted, Mr. Radakovich requested that his employment and that of Mr. Hartshorn be made retroactively effective as of October 30, 1997.

Additionally, Mr. Radakovich filed an application for allowance of interim compensation under § 331 seeking approval of $3,394.15[4] in costs and attorney's fees. The attachment to this application reflects that compensation is sought for the period of time commencing on the filing of the initial chapter 13 petition. This application was denied without prejudice at the hearing, but certain aspects are addressed further below.

DISCUSSION

Mr. Radakovich contends that there has been at no time an intentional effort to circumvent the disclosure and related requirements of the code. He further submits that there is no "actual" conflict of interest in his representation of the Debtors, notwithstanding the existence of his claim to compensation for services rendered in the chapter 13 or his pre-filing lien.

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[3] There is no code provision or rule requiring additional disclosure by a chapter 13 debtor's counsel as to disinterestedness similar to that which is required for chapter 11 debtor's counsel who seek to be employed by the debtor in possession. *See* § 327(a), Rule 2014(b).

[4] Mr. Radakovich has already applied the $797.50 he received from the Debtors prepetition to total fees and costs of $4,191.65.

The U.S. Trustee has not taken issue with counsel's representations as to intent. Nevertheless, the U.S. Trustee urges that, pursuant to the code and well-established case law, Mr. Radakovich is disqualified to be counsel for the Debtors. The Court agrees. Therefore, his employment cannot be approved. Lack of approval of his employment will necessarily result in a denial of all requested compensation for chapter 11 services.

The Court appreciates that this may have an impact upon the Debtors' reorganization due to the stage of the reorganization at which these issues surfaced[5] and the possible difficulty of obtaining replacement counsel. However, this is a crisis of counsel's making, not the Court's.

Counsel asks the Court to "equitably" waive strict compliance, based on his proferred assurances as to the lack of improper intent, and based on the likely impact on his clients. He asks too much. "While Section 105(a) endows bankruptcy courts with broad equitable powers, Section 105(a) may be exercised only in a manner not inconsistent with the provisions of the Code." *Gurney v. State of Arizona Dep't of Revenue (In re Gurney)*, 192 B.R. 529, 537 (9th Cir. BAP 1996).

I. Approval of Employment of Professionals

On January 8, 1999, Mr. Radakovich filed a "Motion to Employ Professional Persons" under § 327 of the code (hereafter the "Application"), a pleading which presents several issues.

First, the Application is not executed by the Debtors, which is the process
contemplated by § 327, Rule 2014 and L.B.R. 2014.1. This is a matter of substance, not just form. Additionally, the Application does not assert from the point of view of the Debtors, who are of necessity the applicants, the information required by § 327 and Rule 2014(a). Nor is the Application accompanied by "verified statements" by the three[6] proposed professionals

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[5] When the rules are followed, employment of professionals and related issues arise at the outset, and do not have the same potential for significant disruption as they do here on the eve of confirmation.

[6] At hearing, and with the U.S. Trustee's concurrence, the Debtors withdrew one of the three requests.

which set forth their qualifications and eligibility. *See* Rule 2014. These failures alone would be sufficient cause for the Court to decline to execute an order approving employment of professionals. *See* Rule 2014 (an order approving employment shall be made only on an application in accord with the rule). But there is here a more serious problem.

The verified statements referred to in Rule 2014 and L.B.R. 2014.1 are designed to elicit disclosure of all connections between the professionals and the debtor in possession sufficient for the Court to evaluate eligibility and insure the disinterestedness of the professionals. Had they been filed in this case, they would have had to reflect that Mr. Radakovich had a prepetition secured claim against the Debtors and, as of the time of commencement of the chapter 11 case, an additional claim against the Debtors for unpaid legal services rendered in the chapter 13 case. Based upon admissions at the time of hearing on February 1, Mr. Hartshorn's statement would have had to disclose that he is a nephew of the Debtors.

The record establishes that Mr. Radakovich is not a disinterested person under § 101(14)(A)[7] because he is a creditor. Mr. Hartshorn is not a disinterested person under § 101(14)(A) because he is an "insider."[8] Because these professionals are not disinterested, they may not be employed under §§ 327(a) and 1107.[9] *In re CIC Investment Corporation*, 175 B.R. 52 (9th Cir. BAP 1994). The code is unambiguous and equity is not available to vary this result. *Id.*

In consideration of the arguments advanced at the hearing about the nature of Mr. Radakovich's "technical" conflict and his lack of actual adversity,

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[7] "'[D]isinterested person' means person that -- (A) is not a creditor, an equity security holder, or an insider; . . . ." § 101(14)(A).

[8] "'[I]nsider' includes -- (A) if the debtor is an individual -- (i) relative of the debtor . . . . " § 101(31)(A)(i). A relative is defined as an "individual related by affinity or consanguinity within the third degree as determined by the common law . . . ." § 101(45).

[9] The situation addressed in *CIC* was directly analogous to that of Mr. Radakovich here, i.e., counsel had a prepetition secured claim. The analysis of the Panel, however, would apply with equal vigor to the disqualification of Mr. Hartshorn based on his statutory lack of disinterestedness.

the Court has evaluated whether there is sufficient room under the statutory structure and case law to do what Mr. Radakovich urges. For example, the Court has considered the argument that Mr. Radakovich might be employed as "special counsel" under § 327(e).[10] However, the Court finds that the language and purpose of § 327(e) would have to be tortured in order to bring it to bear upon the present situation. Such a manipulation of statutory language was rejected in *CIC*.[11] It simply will not work.

The Panel in *CIC* agreed, and this Court agrees, with the following statement from *In re Michigan General Corporation*, 77 B.R. 97, 106 (N.Texas 1987):

> This court is not inclined to measure a degree of disinterestedness or interestedness to see whether it is sufficient to qualify or disqualify. A lack of disinterestedness on the part of a professional. . .is, without any exception known to this court, a disqualifying fact. [Citations omitted.]

CIC, 175 B.R. at 56. The statute does not ask the Court to weigh or evaluate disinterestedness once it is identified. *Accord In re Leypoldt*, 95 I.B.C.R. 220, 1995 WL 562183 (Bankr.D. Idaho 1995).

The Court has also considered, but rejects, counsel's argument for leniency based on his lack of ongoing familiarity with code requirements.[12] Practitioners in bankruptcy court, particularly those wishing to represent debtors in possession reorganizing under chapter 11, are obliged to know these code and rule requirements. Employment and disclosure issues are fundamental to the chapter 11 process and have been the subject of much case law, commentary, and even continuing legal education seminars in this District.

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[10] That section does not automatically disqualify professionals because of their prior representation of a debtor.

[11] At 175 B.R. at 55-56 (there involving construction of § 1107(b)).

[12] This argument is hard to square with *In re Lindsey*, 1995 WL 472120 (Bankr.D. Idaho 1995), a decision involving Mr. Radakovich addressing many of these same code and rule requirements.

For the preceding reasons, the application for approval of employment of Messrs. Radakovich and Hartshorn as chapter 11 professionals is denied.

II. Nunc Pro Tunc Approval

The inability of the Court to approve either professional's employment moots the question of whether that approval can be entered *nunc pro tunc*. However, the Court would note in passing that *In re Mehdipour*, 202 B.R. 474, 479 (9th Cir. BAP 1996) (citing *THC Financial Corporation*, 837 F.2d 389, 392 (9th Cir. 1988)), requires a showing of "exceptional circumstances" whenever *nunc pro tunc* approval is sought.[13] Here, there was no such showing.

III. Application for Interim Compensation

The application for interim compensation was denied without prejudice at the hearing, however this topic merits further discussion. To the extent that the Application seeks compensation for services to the chapter 11 Debtors, the Application must be and is denied. *In re Ferreira*, 95 I.B.C.R. 282, 283 (Bankr.D. Idaho 1995); *In re Leed*, 97.3 I.B.C.R. 95, 96 (Bankr.D. Idaho 1997); *Lindsey*, 1995 WL 472120 (services provided and costs incurred before the effective date of approval of employment are not compensable). On the other hand, to the extent the Application seeks compensation for services to the chapter 13 Debtors, Mr. Radakovich is granted leave to reapply.

Mr. Radakovich requested total compensation of $4,191.65, of which $2,079.15 represented costs and fees associated with the chapter 13 case. Mr. Radakovich has already applied against this amount $797.50 he had previously collected from the Debtors. Mr. Radakovich may, therefore, renew his application as to the remaining costs and fees of $1,281.65, which relate solely to his representation of the Debtors while they were chapter 13 Debtors.

In so doing, Mr. Radakovich should pay careful attention to §

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[13] Interestingly, the Court in *Mehdipour* also noted that *nunc pro tunc* approval does not alleviate the professional from meeting the requirements of § 327 and that he still must show that he was disinterested -- clearly a problem here. The opinion also indicates that bankruptcy court orders authorizing employment of professionals in violation of § 327 (i.e., where there is a disqualifying condition) are void *ab initio*. *Mehdipour*, 202 B.R. at 479.

330(a)(3)(A), (4)(A) and (4)(B), and Rule 2016. The renewed application should have better detail for the time entries than the current Application. Also, a review of the U.S. Trustee's fee guidelines would be instructive in the preparation of the application, for example with regard to specificity of time descriptions and the appropriateness of flat fees charged for long distance charges and facsimile transmissions.

CONCLUSION AND ORDER

Employment by the Debtors of Mr. Radakovich and Mr. Hartshorn as professionals is DENIED. Mr. Radakovich's application for interim compensation is DENIED to the extent it seeks compensation for chapter 11 services, and DENIED without prejudice to renewal to the extent it seeks compensation for chapter 13 services.

Dated this 5th day of March, 1999.